

AUDIT OPINIONS





INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

January 7, 2003

**MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT AND COMPTROLLER)**

SUBJECT: Independent Auditor's Report on the Department of the Navy General Fund
Fiscal Year 2002 Principal Financial Statements (Report No. D-2003-044)

The Chief Financial Officers Act of 1990, as amended, requires the Inspector General of the Department of Defense to audit the accompanying Consolidated Balance Sheet of the Department of the Navy General Fund as of September 30, 2002 and 2001, the related Consolidated Statements of Net Cost and Changes in Net Position, and the Combined Statements of Financing and Budgetary Resources for the fiscal years then ended. These financial statements are the responsibility of Department of the Navy management. The Department of the Navy is also responsible for implementing effective internal control and for complying with laws and regulations. We are including the required reports on internal control and compliance with laws and regulations.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that the Department of the Navy has identified material deficiencies in accounting and financial management systems, policies and procedures, internal control structure, and compliance with laws and regulations. Therefore, we did not perform auditing procedures to support material amounts on the financial statements. In addition, other auditing procedures were not performed because Section 1008(d) of the FY 2002 National Defense Authorization Act requires the Inspector General of the Department of Defense to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. The material deficiencies reported by the Department of the Navy also affect the reliability of certain information contained in the accompanying Management Discussion and Analysis and certain other information—much of which is taken from the same data sources as the principal financial statements.¹ These deficiencies would have precluded an audit opinion. As described above, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.

General Fund Audit Opinion

Summary of Internal Control

In planning and performing our audit, we considered the Department of the Navy internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance but not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance because previously identified reportable conditions² were material and continue to exist in the following areas: accounting and financial management systems, policies and procedures, internal control structure, and compliance with laws and regulations. A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance that are material in relation to the financial statements would be prevented or detected on a timely basis. Our internal control work would not necessarily disclose all material weaknesses. See the Attachment for additional details on material internal control weaknesses.

Summary of Compliance with Laws and Regulations

We also considered the Department of the Navy General Fund compliance with applicable laws and regulations. Management has acknowledged that critical financial management and feeder systems do not comply with Federal financial systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level, as required under Federal Financial Management Improvement Act of 1996. These material compliance issues have been previously reported. In accordance with Section 1008 of the National Defense Authorization Act and the assertions made by management, we limited our audit work in this area. Therefore, we did not determine whether the Department of the Navy was in compliance with all applicable laws and regulations related to financial reporting. See the Attachment for additional details on compliance with laws and regulations.

In order for DoD to comply with statutory reporting requirements and applicable financial systems requirements, the Under Secretary of Defense (Comptroller)/Chief Financial Officer is developing the DoD-wide financial management enterprise architecture. The DoD anticipates developing and implementing the financial management enterprise architecture by 2007. Until the architecture is developed and implemented, the Department of the Navy will be unable to fully comply with the statutory reporting requirements.

We caution that other noncompliance may have occurred and not been detected. Further, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to express an opinion on compliance with applicable laws and regulations.

² Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements.



Management Responsibility

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles,
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act of 1982 are met,
- ensuring that the Department of the Navy financial management systems substantially comply with Federal Financial Management Improvement Act of 1996 requirements, and
- complying with applicable laws and regulations.



David K. Steensma
Deputy Assistant Inspector General
for Auditing



Attachment
As stated

General Fund Audit Opinion

Reports on Internal Control and Compliance with Laws and Regulations

Internal Control

Management is responsible for implementing effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly; and that assets are safeguarded. We did not perform tests of internal control over financial reporting of the Department of the Navy General Fund financial statements and we did not obtain sufficient evidence to support or express an opinion on internal control. We limited our audit tests because previously identified reportable conditions, all of which are material, continue to exist in the following areas:

- **Accounting and Financial Management Systems.** Department of the Navy system deficiencies included the inability to implement elements of generally accepted accounting principles (GAAP) and inadequate implementation of the U.S. Government Standard General Ledger.
- **Policies and Procedures.** Department of the Navy financial reporting is not accurate due to inadequate guidance and lack of standard operating procedures, reconciliations are not adequately completed, and valuation of inventory and Operating Materials and Supplies does not comply with GAAP.
- **Efficiency and Effectiveness of Operations.** Department of the Navy legacy systems do not maintain the historical cost data necessary to comply with Statement of Federal Financial Accounting Standard No. 3, "Accounting for Inventory and Related Property"; the accuracy and reliability of financial data is adversely affected by non-financial feeder systems and journal voucher adjustments; and problem disbursements cause data errors and unreliable obligation data.

Compliance with Laws and Regulations

Management is responsible for compliance with existing laws and regulations related to financial reporting. Our work to determine compliance with selected provisions of the applicable laws and regulations was limited because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist. Therefore, we did not attempt to determine whether the Department of the Navy General Fund was in compliance with the provisions of all applicable laws and regulations related to financial reporting. Our objective was not to express an opinion on compliance with applicable laws and regulations.

The Department of the Navy is required to comply with the following statutory financial management systems reporting requirements.

The Federal Financial Management Improvement Act of 1996 requires the Department of the Navy to establish and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. In addition, the Federal Managers' Financial Integrity Act of 1982 requires the Department of the Navy to evaluate the systems and to annually report whether those systems are in compliance with applicable requirements. The Chief Financial Officers Act of 1990 requires the Department of



the Navy to prepare a 5-year Financial Management Plan describing activities that the Department of the Navy will conduct during the next 5 years to improve financial management.

The Department of the Navy acknowledged that many of its critical financial management and feeder systems do not comply with Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. In an attempt to comply with statutory reporting requirements and applicable financial systems requirements, DoD plans to develop a DoD-wide financial management enterprise architecture. The architecture is intended to provide a "blueprint" of the DoD financial management systems and processes to initiate a comprehensive financial management reform effort. Until the architecture is developed, the Department of the Navy will be unable to fully comply with the statutory reporting requirements. Therefore, we did not perform tests of compliance for these requirements.

Audit Disclosures

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged in his preliminary management representation, dated August 9, 2002, that financial management systems are not in compliance with provisions of the Federal Financial Management Improvement Act because they cannot provide adequate evidence supporting various material amounts on the financial statements. As a result of management's representations, we performed only limited audit procedures necessary to issue a disclaimer of opinion. Therefore, we were unable to obtain adequate evidential matter to form or express an opinion on the financial statements, internal controls, and compliance with laws and regulations.

Accordingly, we did not conduct audit followup work on deficiencies related to material line items identified in the Naval Audit Service FY 2001 Department of the Navy General Fund financial statement audit. The material line items included: Fund Balance with Treasury; General Property, Plant, and Equipment; Inventory and Related Materials; Accounts Receivable; and Accounts Payable. The Department of the Navy has acknowledged that these deficiencies continue to exist.

In addition, we did not perform audit tests of Department of the Navy General Fund compliance with the following laws: Federal Financial Management Improvement Act, Anti-deficiency Act, provisions governing claims of the United States Government, Federal Credit Reform Act of 1990, Pay and Allowance System for Civilian Employees, and the Prompt Payment Act.



Working Capital Fund Audit Opinion



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

January 7, 2003

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Independent Auditor's Report on the Department of the Navy Working Capital Fund
Fiscal Year 2002 Principal Financial Statements (Report No. D-2003-045)

The Chief Financial Officers Act of 1990, as amended, requires the Inspector General of the Department of Defense to audit the accompanying Consolidated Balance Sheet of the Department of the Navy Working Capital Fund as of September 30, 2002 and 2001, the related Consolidated Statements of Net Cost and Changes in Net Position, and the Combined Statements of Financing and Budgetary Resources for the fiscal years then ended. These financial statements are the responsibility of the Department of the Navy management. The Department of the Navy is also responsible for implementing effective internal control and for complying with laws and regulations. We are including the required reports on internal control and compliance with laws and regulations.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that the Department of the Navy has identified material deficiencies in accounting and financial management systems, policies and procedures, internal control structure, and compliance with laws and regulations. Therefore, we did not perform auditing procedures to support material amounts on the financial statements. In addition, other auditing procedures were not performed because Section 1008(d) of the FY 2002 National Defense Authorization Act requires the Inspector General of the Department of Defense to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. The material deficiencies reported by the Department of the Navy also affect the reliability of certain information contained in the accompanying Management Discussion and Analysis and certain other information—much of which is taken from the same data sources as the principal financial statements.¹ These deficiencies would have precluded an audit opinion. As described above, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.





Summary of Internal Control

In planning and performing our audit, we considered the Department of the Navy internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance but not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance because previously identified reportable conditions² were material and continue to exist in the following areas: accounting and financial management systems, policies and procedures, internal control structure, and compliance with laws and regulations. A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance that are material in relation to the financial statements would be presented or detected on a timely basis. Our internal control work would not necessarily disclose all material weaknesses. See the Attachment for additional details on material internal control weaknesses.

Summary of Compliance with Laws and Regulations

We also considered the Department of the Navy Working Capital Fund compliance with applicable laws and regulations. Management has acknowledged that critical financial management and feeder systems do not comply with Federal financial systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level, as required under Federal Financial Management Improvement Act of 1996. These material compliance issues have been previously reported. In accordance with Section 1008 of the National Defense Authorization Act and the assertions made by management, we limited our audit work in this area. Therefore, we did not determine whether the Department of the Navy was in compliance with all applicable laws and regulations related to financial reporting. See the Attachment for additional details on compliance with laws and regulations.

In order for DoD to comply with statutory reporting requirements and applicable financial systems requirements, the Under Secretary of Defense (Comptroller)/Chief Financial Officer is developing the DoD-wide financial management enterprise architecture. The DoD anticipates developing and implementing the financial management enterprise architecture by 2007. Until the architecture is developed and implemented, the Department of the Navy will be unable to fully comply with the statutory reporting requirements.

We caution that other noncompliance may have occurred and not been detected. Further, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to, and we do not, express an opinion on compliance with applicable laws and regulations. See the Attachment for additional details on compliance with laws and regulations.

² Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements.

Working Capital Fund Audit Opinion

Management Responsibility

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles,
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act of 1982 are met,
- ensuring that the Department of the Navy financial management systems substantially comply with Federal Financial Management Improvement Act of 1996 requirements, and
- complying with applicable laws and regulations.



David K. Steensma
Deputy Assistant Inspector General
for Auditing

Attachment
As stated



Reports on Internal Control and Compliance with Laws and Regulations

Internal Control

Management is responsible for implementing effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly; and that assets are safeguarded. We did not perform tests of internal control over financial reporting of the Department of the Navy Working Capital Fund financial statements and did not obtain sufficient evidence to support or express an opinion on internal control. We limited our audit tests because previously identified reportable conditions, all of which are material, continue to exist in the following areas:

- **Accounting and Financial Management Systems.** Department of the Navy system deficiencies included the inability to implement elements of generally accepted accounting principles (GAAP) and inadequate implementation of the U.S. Government Standard General Ledger. Also, accounting entries were needed to correct errors caused by differences between accounting systems.
- **Policies and Procedures.** Department of the Navy financial reporting is not accurate due to inadequate guidance and lack of standard operating procedures; reconciliations are not adequately completed; and valuation of inventory and Operating Materials and Supplies does not comply with GAAP.
- **Efficiency and Effectiveness of Operations.** Existence, location, and condition of General Property, Plant, and Equipment in the Department of the Navy are not adequately maintained and reported; the accuracy and reliability of financial data is adversely affected by non-financial feeder systems and journal voucher adjustments; and problem disbursements cause data errors and unreliable obligation data.

Compliance with Laws and Regulations

Management is responsible for compliance with existing laws and regulations related to financial reporting. Our work to determine compliance with selected provisions of the applicable laws and regulations was limited because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist. Therefore, we did not attempt to determine whether the Department of the Navy was in compliance with the provisions of all applicable laws and regulations related to financial reporting. Our objective was not to express an opinion on compliance with applicable laws and regulations.

The Department of the Navy is required to comply with the following statutory financial management systems reporting requirements.

The Federal Financial Management Improvement Act of 1996 requires the Department of the Navy to establish and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. In addition, the Federal Managers' Financial Integrity Act of 1982 requires the Department of the Navy to evaluate the systems and to annually report whether those systems are in compliance with applicable requirements. The Chief Financial Officers Act of 1990 requires the Department of



Working Capital Fund Audit Opinion

the Navy to prepare a 5-year Financial Management Plan describing activities that the Department of the Navy will conduct during the next 5 years to improve financial management.

The Department of the Navy acknowledged that many of its critical financial management and feeder systems do not comply with Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. Prior audits support management's conclusions. In an attempt to comply with statutory reporting requirements and applicable financial systems requirements, DoD plans to develop a DoD-wide financial management enterprise architecture. The architecture is intended to provide a "blueprint" of the DoD financial management systems and processes to initiate a comprehensive financial management reform effort. Until the architecture is developed, the Department of the Navy will be unable to fully comply with the statutory reporting requirements. Therefore, we did not perform tests of compliance for these requirements.

Audit Disclosures

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged in his preliminary management representation letter, dated August 9, 2002, that financial management systems are not in compliance with provisions of the Federal Financial Management Improvement Act because they cannot provide adequate evidence supporting various material amounts on the financial statements. As a result of management's representations, we performed only limited audit procedures necessary to issue a disclaimer of opinion. Therefore, we were unable to obtain adequate evidential matter to form or express an opinion on the financial statements, internal controls, and compliance with laws and regulations.

Accordingly, we did not conduct audit followup work on deficiencies related to material line items identified in the Naval Audit Service FY 2001 Navy Working Capital Fund financial statement audit. The material line items included: Fund Balance with Treasury; General Property, Plant, and Equipment; Inventory and Related Materials; Accounts Receivable; and Accounts Payable. The Department of the Navy has acknowledged that these deficiencies continue to exist.

In addition, we did not perform audit tests of Department of the Navy compliance with the following laws: Federal Financial Management Improvement Act, Anti-deficiency Act, provisions governing claims of the United States Government, Federal Credit Reform Act of 1990, Pay and Allowance System for Civilian Employees, and the Prompt Payment Act.

